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United States
Department of Defense



Controls Over the Department of the
Navy Working Capital Fund Inventory
Stored at Non-Defense Logistics Agency
Organizations

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Acronyms

ACU	Assault Craft Unit
FALSC	Fleet Aviation Logistics Support Center
FISC	Fleet and Industrial Supply Center
ILSMIS	Industrial Logistics Support Management Information System
MALS	Marine Aviation Logistics Squadron
MFCS	Material Financial Control System
NAS	Naval Air Station
NAVICP	Naval Inventory Control Point
NAVSUP	Naval Supply Systems Command
NIIN	National Item Identification Number
NSM	Navy Supply Management
NWCF	Navy Working Capital Fund



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-4704

May 13, 2008

MEMORANDUM FOR NAVAL INSPECTOR GENERAL

SUBJECT: Report on Controls Over the Department of the Navy Working Capital Fund
Inventory Stored at Non-Defense Logistics Agency Organizations
(Report No. D-2008-092)

We are providing this report for information and use. We considered management comments on a draft of this report when preparing the final report.

Comments on the draft of this report conformed to the requirements of DoD Directive 7650.3 and left no unresolved issues. Therefore, no additional comments are required.

We appreciate the courtesies extended to the staff. Questions should be directed to Mr. Kenneth B. VanHove at (216) 706-0074 extension 245 or Mr. Joseph M. Kaseler at (216) 706-0074 extension 263. See Appendix F for the report distribution. The team members are listed inside the back cover.

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Report No. D-2008-092

(Project No. D2007-D000FC-0162.000)

May 13, 2008

Controls Over the Department of the Navy Working Capital Fund Inventory Stored at Non-Defense Logistics Agency Organizations

Executive Summary

Who Should Read This Report and Why? DoD inventory managers and others who rely on the accuracy of the data for the Department of the Navy Working Capital Fund inventory stored at non-Defense Logistics Agency organizations, specifically the Navy Supply Management activities, should read this report. The users of this audit report will benefit from the review of the controls over the Department of the Navy Working Capital Fund inventory and will gain information that can improve accountability.

Background. The Department of the Navy (Navy) uses the Navy Working Capital Fund (NWCF) as a major support element for the operating forces. NWCF activities perform various functions including supply management, depot maintenance, research and development, transportation, and base support. The Naval Supply Systems Command oversees the supply management function. In the FY 2006 Financial Statements, the Navy reported \$13.8 billion, at latest acquisition cost, in inventory and related property. Approximately \$12.6 billion of the amount was reported under the Supply Management Business Area.

Results. The physical inventory controls at 11 Navy Supply Management activities were generally adequate to accurately report and safeguard NWCF inventory. However, inaccurate inventory data existed within the Material Financial Control System and the local logistics systems. Although these inaccuracies did not result in material inventory discrepancies, they could cause delays in issuing supplies to the warfighter. The Naval Supply Systems Command should notify the Fleet and Industrial Supply Center Norfolk Crane Division (Crane Division) of systemic programming errors so that the Crane Division can initiate and monitor System Change Requests for resolution through the Industrial Logistics Support Management Information System Function Review Board. The Naval Supply Systems Command should also ensure warehouse personnel are properly and continuously trained to receive, store, and ship inventory items to optimize the accuracy and accountability of inventory at each Navy Supply Management activity. The Naval Inventory Control Point personnel should continue implementing the automated procedure to ensure accuracy and accountability of inventory data between the Material Financial Control System and the Relational Supply system. Fleet and Industrial Supply Center Norfolk should implement a location survey program at its Crane Division to provide greater accuracy and accountability of inventory. See the Finding section of the report for detailed recommendations.

The Navy Supply Management activities accepted responsibility for the inaccuracies and have already addressed or are currently working to resolve a majority of these discrepancies. The Navy has acknowledged that ensuring the right material is provided at the proper place, time, and cost is vital to equipping and sustaining our warfighting units.

Management Comments. We received comments from the Assistant Secretary of the Navy (Financial Management and Comptroller) concurring with our recommendations. The comments were responsive to the issues we identified in our report, and no additional comments are needed. See the Finding section of the report for a discussion of management comments and the Management Comments section of the report for the complete text of the comments.

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Background

The Department of the Navy (Navy) uses the Navy Working Capital Fund (NWCF) as a major support element for the operating forces. NWCF activities perform various functions including supply management, depot maintenance, research and development, transportation, and base support. In the FY 2006 Financial Statements, the Navy reported \$13.8 billion, at latest acquisition cost, in inventory and related property. Approximately \$12.6 billion of the amount was reported under the Supply Management Business Area.

Navy Supply Management (NSM). The Naval Supply Systems Command (NAVSUP) oversees the NSM function. Its primary mission is to provide U.S. Naval Forces with supplies and services. NAVSUP is headquartered in Mechanicsburg, Pennsylvania, and employs a worldwide workforce of nearly 23,000 military and civilian personnel. NSM activities buy and maintain stocks of material for sale to Navy operating units and other customers. NSM is supported by seven Fleet and Industrial Supply Centers (FISCs) and the Naval Inventory Control Point (NAVICP). The FISCs provide logistics support services to the fleet, shore activities, and overseas bases. NAVICP provides program and supply support for Navy inventory items.

Material Financial Control System (MFCS). MFCS is the Navy's accounting system, which performs general ledger, accounts payable, management information, accounts receivable, inventory financial reports, and funds control functions for wholesale and retail supply management. MFCS provides a centralized database for transactional data allowing improved inventory accountability (control of NWCF material) and financial accuracy. MFCS is designed to interface with the local logistics systems and other applications used by NAVSUP and the Defense Finance and Accounting Service.

Local Logistics Systems. NSM activities use five logistics systems to account for NWCF inventory. We reviewed inventory data in three of these logistics systems: the Industrial Logistics Support Management Information System (ILSMIS), Relational Supply (R-Supply), and the Uniform Automated Data Processing System (U2).

- **ILSMIS.** ILSMIS is an inventory, logistics, and financial management hardware/software suite used by the Naval Surface and Undersea Warfare Centers.
- **R-Supply.** R-Supply is an inventory, logistics, and financial management hardware/software suite used by various Navy activities and ships.
- **U2.** U2 is an inventory, logistics, and financial management hardware/software suite used by FISCs and partner sites.

Inventory Identification. DoD inventory items have classifications and unique identifiers. The National Stock Number is an inventory identifier, consisting of

the combined four-digit Federal Supply Class¹ and the nine-digit National Item Identification Number (NIIN).² Supply items are assigned condition codes, which are used to classify material in terms of readiness for issue and use, or to identify action under way to change the status of material. For example, Condition Code A is a serviceable material, which is ready for issue. Condition Code F is an unserviceable, repairable material.

Warehouse Refusals. A warehouse refusal occurs when the storage activity record indicates inventory is available for issue but the inventory cannot be found at the storage activity. Warehouse refusals generally occur because of one of the following conditions: inventory not in requested condition, expired shelf-life, poor receiving and storage practices, unresolved unreconciled balances, or a change in condition not recorded on the stock record.

Objectives

Our overall audit objective was to evaluate the controls over the NWCF inventory stored at non-Defense Logistics Agency organizations. Specifically, we reviewed the physical inventory control program at selected Department of the Navy Supply Management activities. See Appendix A for a discussion of the scope and methodology.

Review of Internal Controls

We did not identify any material internal control weaknesses at the NSM activities that we reviewed. Further, the discrepancies we found in the inventory records were insignificant compared to the quantity and value of the inventory reviewed. However, improvements could be made in the controls over the accuracy of the local logistics systems data and the receiving, storing, and shipping practices of NSM activities.

¹ The Federal Supply Class designates the general commodity grouping of the item of supply.

² The NIIN identifies each item of supply.

Adequacy of Controls Over Navy Working Capital Fund Inventory

Physical inventory controls at 11 NSM activities were generally adequate to accurately report and safeguard NWCF inventory. However, inaccurate inventory data existed within MFCS and the local logistics systems. The inaccuracies existed because of:

- programming errors during the ILSMIS system conversion;
- incomplete reconciliation procedures between MFCS data and the local logistics systems data; and
- improper receipt, storage, and shipment of inventory items at NSM activities.

Although these inaccuracies did not result in material inventory discrepancies, they could cause delays in issuing supplies to the warfighter.

Accuracy of MFCS Data

MFCS contained inaccurate quantities at 5 of the 11 NSM activities reviewed. We identified 25 discrepancies between MFCS and the local logistics systems. Programming errors during system conversion and incomplete reconciliation procedures between MFCS data and the local logistics system caused the inaccurate data.

Programming During System Conversion. We identified 18 discrepancies, valued at \$2 million,³ between MFCS and ILSMIS data. FISC Norfolk Crane Division's (Crane Division) local logistics system, ILSMIS, underwent a system conversion on May 7, 2007. The original operating system software consisted of over 3 million lines of code, which had to be read and converted to create the new system. Despite intensive testing by systems personnel, programming errors caused problems in the creation and processing of transaction item reports.⁴ For example, ILSMIS reported a balance of two items for one NIIN for which MFCS had a zero balance. After researching the problem, systems personnel determined that a transaction item report for a gain of two did not process through to MFCS. NAVICP personnel stated that they addressed the issue by manually posting the transaction item report in MFCS. Crane Division personnel also stated that systems personnel were taking action to correct programming errors. NAVSUP should notify the Crane Division of systemic programming errors so that the

³ All values of inventory for discrepancies, sample, and universe are valued at standard price.

⁴ A mechanical transmission from an activity to an inventory control point reporting a change in stock position such as an issue, receipt, or adjustment.

Crane Division can initiate and monitor System Change Requests for resolution through the ILSMIS Function Review Board.

Reconciliation Process. We identified seven discrepancies, valued at \$2.8 million, between MFCS and R-Supply. NAVICP had a reconciliation process to compare local logistics system data to MFCS data. If data within local logistic systems did not match data within MFCS, the process produced an unreconciled balance. However, the seven discrepancies occurred because NAVICP did not have a process in place during the time of the audit to compare data in MFCS back to data within R-Supply. For example, MFCS included two items for one NIIN; however, these items were not included in R-Supply. After researching the discrepancy, NAVICP personnel determined that the anomaly occurred during a 2004 system conversion; they updated MFCS with the correct data. NAVICP personnel stated that they developed an automated procedure in October 2007 to compare data in MFCS back to data within R-Supply. NAVICP personnel should continue implementing the automated procedure to ensure accuracy and accountability of inventory data between the systems.

Accuracy of Local Logistics Systems Data

The local logistics systems contained inaccurate quantities or locations at 9 of the 11 NSM activities reviewed during our record-to-floor⁵ testing. We identified 75 discrepancies, valued at \$5.5 million, between the local logistics systems and the physical inventory counts. In addition, the local logistics systems contained inaccurate quantities or locations at 4 of the 11 NSM activities reviewed during our floor-to-record⁶ testing. We identified seven discrepancies between the local logistics systems and the physical inventory counts.

Warehouse personnel did not always properly receive and store items, which caused inaccuracies within the local logistics systems. For example, at one NSM activity, we identified a NIIN which had an on-hand quantity of nine items within ILSMIS; however, we counted seven items. Warehouse personnel researched the discrepancy and found two items in an unrecorded location. The warehouse personnel addressed the issue by updating the records to include the unrecorded location. Warehouse personnel stated that the site does not perform location surveys, but they are working on implementing location surveys as part of the physical inventory control tests. FISC Norfolk should implement a location survey program at its Crane Division to provide greater accuracy and accountability of inventory.

Warehouse personnel did not always ship the correct quantity of items, which caused inaccuracies within the local logistics systems. For example, at one NSM activity the record-to-floor count did not match the quantity within R-Supply. This activity's research indicated that warehouse personnel shipped five fewer

⁵ Record-to-floor testing verifies that the information within the inventory system matches the on-hand quantity and location of the item in the warehouse.

⁶ Floor-to-record testing verifies that the on-hand quantity and location of the item in the warehouse matches the information within the inventory system.

items than were ordered. The activity addressed the discrepancy by sending additional items to fulfill the correct quantity requirement. NSM activity officials stated that continuous turnover of warehouse personnel makes it difficult for consistent warehouse practices to be performed. NAVSUP should ensure warehouse personnel are properly and continuously trained to receive, store, and ship inventory items to optimize the accuracy and accountability of inventory at each NSM activity.

Impact of Inventory Accuracy

Physical inventory controls at the 11 NSM activities were generally adequate to accurately report and safeguard NWCF inventory; however, NWCF inventory systems contained inaccurate inventory data for 96 sample items.⁷ Inventory accuracy impacts a broad spectrum ranging from DoD budget credibility to warfighter readiness. Whenever material on an accountable record cannot be found, warfighter readiness may be impacted. Although the inaccurate data did not result in material inventory discrepancies, the inaccuracies could cause delays in issuing supplies to the warfighter. For example, at 1 NSM activity, MFCS and the local logistics system identified 21 items for a NIIN; the actual quantity was 11 items. The incorrect quantity within the systems resulted in a warehouse refusal. The opportunity for undetected theft also increases when accountable records do not agree with material in storage.

Management Actions

The NSM activities accepted responsibility for the inaccuracies and have already addressed or are currently working to resolve a majority of these discrepancies. The Navy has acknowledged that ensuring the right material is provided at the proper place, time, and cost is vital to equipping and sustaining our warfighting units.

Management Comments on the Finding and Audit Response

Management Comments. The Assistant Secretary of the Navy (Financial Management and Comptroller) concurred with the finding. The Assistant Secretary of the Navy (Financial Management and Comptroller) stated that the inventory discrepancies noted at FISC Norfolk Crane Division caused from the ILSMIS conversion process have been identified for corrective resolution. All priority one and 80 percent of priority two system discrepancies identified during the audit have been rectified. In addition, a System Project Team has taken an aggressive approach to identify future system issues and to monitor the timeliness of the resolution process.

⁷ Sample items represent the NIINs reviewed at each NSM activity in Crane, Indiana; Norfolk, Virginia; and San Diego, California.

Audit Response. The Assistant Secretary of the Navy (Financial Management and Comptroller) comments conformed to requirements and no additional comments are needed.

Recommendations, Management Comments, and Audit Response

1. We recommend the Commander, Naval Supply Systems Command:

a. Notify the Fleet and Industrial Supply Center Norfolk Crane Division of systemic programming errors so that the Crane Division can initiate and monitor System Change Requests for resolution through the Industrial Logistics Support Management Information System Function Review Board.

Management Comments. The Assistant Secretary of the Navy (Financial Management and Comptroller) concurred and stated that the Fleet and Industrial Supply Center Norfolk Crane Division established a process to identify systemic problems that occur in the Industrial Logistics Support Management Information System.

Audit Response. The Assistant Secretary of the Navy (Financial Management and Comptroller) comments were responsive and conform to requirements; no additional comments are needed.

b. Ensure warehouse personnel are properly and continuously trained to receive, store, and ship inventory items to optimize the accuracy and accountability of inventory at each Navy Supply Management activity.

Management Comments. The Assistant Secretary of the Navy (Financial Management and Comptroller) concurred and stated that Commander, Naval Supply Systems Command will ensure warehouse personnel are properly and continuously trained. In addition, all Fleet and Industrial Supply Center assessable units which address training will be revised to include warehouse personnel training and training records will properly documented. The estimated completion date is October 31, 2008.

Audit Response. The Assistant Secretary of the Navy (Financial Management and Comptroller) comments were responsive and conform to requirements; no additional comments are needed.

2. We recommend the Commander, Naval Inventory Control Point continue implementing the automated procedure to ensure accuracy and accountability of inventory data between the Material Financial Control System and the Relational Supply system.

Management Comments. The Assistant Secretary of the Navy (Financial Management and Comptroller) concurred and stated that the Naval Inventory Control Point will continue working with activities to resolve existing

inaccuracies and implementing procedures to ensure accuracy and accountability of inventory. The estimated completion date is April 1, 2010.

Audit Response. The Assistant Secretary of the Navy (Financial Management and Comptroller) comments were responsive and conform to requirements; no additional comments are needed.

3. We recommend the Commanding Officer, Fleet and Industrial Supply Center Norfolk implement a location survey program at its Crane Division to provide greater accuracy and accountability of inventory at each Navy Supply Management activity.

Management Comments. The Assistant Secretary of the Navy (Financial Management and Comptroller) concurred and stated that the Fleet and Industrial Supply Center Norfolk Crane Division established a requirement to complete 100 percent location survey for all Navy Working Capital Fund inventory within 3 years. Location survey completion has been incorporated within the Inventory Schedule compliance reporting process that is monitored at the Fleet and Industrial Supply Center Norfolk. The estimated completion date is April 1, 2010.

Audit Response. The Assistant Secretary of the Navy (Financial Management and Comptroller) comments were responsive and conform to requirements; no additional comments are needed.

Other Matters of Interest

Proper labeling is necessary for efficient and accurate management of inventory items; however, NSM activity warehouse personnel did not always properly label inventory items. We noted inadequate labeling at 7 of the 11 activities, which included the following:

- Unreadable labels on items stored in outdoor locations.
- Labels with the wrong NIIN.
- Labels with the wrong condition code.
- Items with no NIIN on packaging.
- Items with multiple NIINs on packaging.

The NSM activities are aware that inventory items were not always properly labeled and are taking action to ensure that this issue is addressed by the warehouse personnel.

Appendix A. Scope and Methodology

We conducted this performance audit from March 2007 through March 2008 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our finding and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our finding and conclusions based on our audit objectives.

To evaluate the controls over the NWCF inventory stored at non-Defense Logistics Agency organizations, we reviewed the Navy's process of safeguarding and accounting for NWCF inventory. During FY 2007, MFCS included a universe of \$15.4 billion in NWCF inventory stored at 176 NSM activities, which used ILSMIS, R-Supply, and U2 as the local logistics system. We used judgmental and statistical sampling to determine whether NSM activities accurately accounted for NWCF inventory. See Appendix B for the Statistical Sample. We also spoke to representatives from the Office of the Under Secretary of Defense (Comptroller)/Chief Financial Officer, NAVSUP, NAVICP, FISC, and 11 NSM activities.

To accomplish the audit objective:

- We contacted the Office of the Under Secretary of Defense (Comptroller)/Chief Financial Officer to determine its role within the NWCF inventory process.
- We met with NAVSUP personnel to obtain a universe of NWCF inventory, gain an understanding of the NWCF inventory process, and identify their role in the NWCF inventory process.
- We met with NAVICP and FISC personnel to identify their role in the NWCF inventory process.
- We performed testing at 11 NSM activities located in Crane, Indiana; Norfolk, Virginia; and San Diego, California to evaluate the controls over the NWCF inventory. Specifically, we interviewed responsible officials and observed security measures to determine whether physical security safeguards were in place to protect NWCF inventory. We also reviewed the inventory audits performed by NSM activity personnel to determine whether the storage activities were performing annual inventories as required by NAVSUP Publication 485, Volume III, "Ashore Supply," July 27, 2000; NAVSUP Publication 723, "Navy Inventory Integrity Procedures," April 19, 2000; and Marine Corps Order P4400.177E, "Marine Corps Aviation Supply Desk-top Procedures," April 2006. In addition, we performed record-to-floor and floor-to-record tests to determine whether the NWCF inventory recorded in the logistics systems existed and was recorded accurately.

Use of Computer-Processed Data. We did not evaluate the general and application controls of ILSMIS, MFCS, R-Supply, and U2. However, we relied on computer-processed data from these systems. We determined data reliability by observing inventories and performing record-to-floor tests, as well as floor-to-record tests. Although we did not evaluate additional controls, it did not affect the results of the audit.

Use of Technical Assistance. The Quantitative Methods Directorate of the DoD Office of the Inspector General provided technical assistance throughout the statistical sampling process. In support of record-to-floor testing, the Quantitative Methods Directorate personnel provided a statistical sample of NIINs of inventory for the NSM activities.

Government Accountability Office High-Risk Area. The Government Accountability Office has identified several high-risk areas in DoD. This report provides coverage of DoD Financial Management and DoD Supply Chain Management high-risk areas.

Prior Coverage

No prior coverage has been conducted on the NWCF inventory stored at non-Defense Logistics Agency organizations during the last 5 years.

Appendix B. Statistical Sample

Population. NAVSUP provided a report listing the values of NWCF inventory stored at NSM activities. We selected 4 of the top 10 NSM activities, based on the highest dollar value of inventory. We formed clusters by adding any other NSM activities with inventory values greater than or equal to approximately \$40 million that were within an approximate hour commute of the four. We identified 11 NSM activities* that met these criteria: the Crane Division in Crane, Indiana; Assault Craft Unit (ACU) 4, Cheatham Annex, Fleet Aviation Logistics Support Center (FALSC) Norfolk, Naval Air Station (NAS) Norfolk, and NAS Oceana in Norfolk, Virginia; and ACU 5, NAS North Island, Marine Aviation Logistics Squadron (MALS) 11, MALS 16, and MALS 39 in San Diego, California. Based on the results of the audit tests at 11 NSM activities located in Crane, Norfolk, and San Diego, we concluded our audit. The 11 NSM activities provided coverage of ILSMIS, R-Supply, and U2.

Sample Plan. The Quantitative Methods Directorate of the DoD Office of the Inspector General provided a statistical sample of NIINs based on the 11 NSM activities to be used during record-to-floor testing. We used a 95-percent confidence level, with approximately 20-percent to 30-percent precision, as the parameters for the sampling plan. Because there were no previous data to draw from, we estimated a coefficient of variation of three times the mean. These parameters yielded a sample size of approximately 300 NIINs for each cluster. Once the NIINs were obtained for each cluster, we stratified by total value and selected the samples per strata accordingly. Table B-1 shows the statistical sampling plan for Crane, Indiana. Table B-2 shows the statistical sampling plan for Norfolk, Virginia. Table B-3 shows the statistical sampling plan for San Diego, California.

Table B-1. Crane Statistical Sampling Plan			
<u>Stratum</u>	<u>Inventory Value</u>	<u>NIIN Population</u>	<u>NIIN Sample</u>
I	Over \$10 million	19	19
II	\$1,000,000 to \$9,999,999	152	100
III	\$500,000 to \$999,999	168	50
IV	\$100,000 to \$499,999	807	80
V	Under \$100,000	<u>4,924</u>	<u>50</u>
Total		6,070	299

* Naval Air Systems Command Interim Supply Support location in San Diego, California, was removed from the scope of the review because it did not use R-Supply, U2, or ILSMIS to account for NWCF inventory.

Table B-2. Norfolk Statistical Sampling Plan			
<u>Stratum</u>	<u>Inventory Value</u>	<u>NIIN Population</u>	<u>NIIN Sample</u>
I	Over \$3 million	48	48
II	\$1,000,000 to \$2,999,999	136	40
III	\$500,000 to \$999,999	228	40
IV	\$100,000 to \$499,999	1,236	80
V	Under \$100,000	<u>94,719</u>	<u>100</u>
Total		96,367	308

Table B-3. San Diego Statistical Sampling Plan			
<u>Stratum</u>	<u>Inventory Value</u>	<u>NIIN Population</u>	<u>NIIN Sample</u>
I	Over \$5 million	31	29
II	\$1,000,000 to \$4,999,999	160	97
III	\$500,000 to \$999,999	171	60
IV	\$100,000 to \$499,999	795	70
V	Under \$100,000	<u>41,609</u>	<u>39</u>
Total		42,766	295

Appendix C. Record-to-Floor Test Results

For a statistical sample comprised of 902 NIINs (997 sample items)* with a value over \$1.5 billion, we compared data from MFCS and the local logistics systems to the inventory items in the storage locations. We tested the quantity, location, and condition code to determine whether the NWCF inventory recorded in the logistics systems existed and was recorded accurately. In addition, we observed the security and physical condition of the items to determine whether items were properly secured or damaged. The table shows the results of the record-to-floor tests:

Record-to-Floor						
Activity	System	Items		Value		Universe (millions)
		Sample	Discrepant	Sample (millions)	Discrepant (millions)	
Crane Division	ILSMIS	299	46	\$ 633.4	\$ 3.2	\$1,295.0
ACU 4	R-Supply	9	0	3.0	0	41.2
Cheatham Annex	U2	57	6	102.8	0.1	294.5
FALSC Norfolk	R-Supply	78	7	1.9	0	102.8
NAS Norfolk	R-Supply	124	13	158.9	3.3	488.4
NAS Oceana	R-Supply	75	1	115.1	0	329.6
ACU 5	R-Supply	13	0	4.4	0	40.8
MALS 11	R-Supply	100	6	161.4	3.3	331.3
MALS 16	R-Supply	69	1	70.6	0	145.7
MALS 39	R-Supply	69	4	58.6	0	122.1
NAS North Island	R-Supply	104	12	209.0	0.5	417.3
Total		997	96	\$1,519.1	\$10.4	\$3,608.7

* The same NIIN may have been reviewed at multiple NSM activities. The audit team counted these instances as one NIIN but as multiple sample items.

Appendix D. Floor-to-Record Test Results

We randomly selected 121 NIINs and compared the data from the inventory items in storage locations to the data recorded in the local logistics systems. We tested the quantity, location, and condition code to determine whether the NWCF inventory was recorded accurately in the local logistics systems. The table shows the results of the floor-to-record tests:

Floor-to-Record			
<u>Activity</u>	<u>System</u>	<u>Sample Items</u>	<u>Discrepant Items</u>
Crane Division	ILSMIS	27	3
ACU 4	R-Supply	9	1
Cheatham Annex	U2	6	0
FALSC Norfolk	R-Supply	7	1
NAS Norfolk	R-Supply	9	0
NAS Oceana	R-Supply	13	0
ACU 5	R-Supply	7	0
MALS 11	R-Supply	10	0
MALS 16	R-Supply	11	2
MALS 39	R-Supply	8	0
NAS North Island	R-Supply	<u>14</u>	<u>0</u>
Total		121	7

Appendix E. Criteria

Office of Management and Budget Circular. Office of Management and Budget Circular A-123, “Management’s Responsibility for Internal Control,” December 2004, identifies management as responsible for developing and maintaining effective internal controls. Internal controls should be designed to provide reasonable assurance regarding prevention, or prompt detection of, unauthorized acquisition, use, or disposition of assets. If weaknesses are found, management is responsible for redesigning or improving the controls. Management should perform a risk assessment that considers the costs and benefits of adjusting existing controls or implementing any new controls.

NAVSUP Publication 485. NAVSUP Publication 485, Volume III, “Ashore Supply,” July 27, 2000, establishes policies and procedures for the operation and management of ashore supply activities and components except those which are directed to operate under afloat instructions. Basic elements of the physical inventory control program address uniform procedures for maintaining accurate records, conducting physical inventories and location surveys/reconciliations, researching potential inventory discrepancies, and for quality control of work processes affecting inventory accuracy. The Commanding Officer or Supply Officer may prescribe additional controls when circumstances require more stringent control.

NAVSUP Publication 723. NAVSUP Publication 723, “Navy Inventory Integrity Procedures,” April 19, 2000, provides policies, procedures, and performance objectives for maintaining controls over material inventories at Navy shore activities and the accuracy of associated inventory items and financial records. The publication includes policies and procedures for physical inventory requirements and location audits. Storage activities are responsible for scheduling inventories at the beginning of each fiscal year to indicate which items are to take priority when the storage activity schedules its inventory workload for the year.

Marine Corps Aviation Supply Desk-Top Procedures. Marine Corps Order P4400.177E, “Marine Corps Aviation Supply Desk-top Procedures,” April 2006, revises the standardized supply procedures used by aviation supply personnel within a MALS Aviation Supply Department. The manual provides procedures for the procurement, receipt, expenditure, inventory, and financial management of materials and services by all MALS using the R-Supply. Regularly scheduled inventory reconciliations are required in order to maintain alignment of actual accountable inventory quantities with those reflected on computer files.

Appendix F. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense (Comptroller)/Chief Financial Officer
Deputy Chief Financial Officer
Deputy Comptroller (Program/Budget)

Department of the Navy

Naval Inspector General
Auditor General, Department of the Navy
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Other Defense Organizations

Director, Defense Finance and Accounting Service

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Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Homeland Security and Governmental Affairs
House Committee on Appropriations
House Subcommittee on Defense, Committee on Appropriations
House Committee on Armed Services
House Committee on Oversight and Government Reform
House Subcommittee on Government Management, Organization, and Procurement,
Committee on Oversight and Government Reform
House Subcommittee on National Security and Foreign Affairs,
Committee on Oversight and Government Reform

Department of the Navy Comments



THE ASSISTANT SECRETARY OF THE NAVY
(FINANCIAL MANAGEMENT AND COMPTROLLER)
1000 NAVY PENTAGON
WASHINGTON DC 20350-1000

April 14, 2008

MEMORANDUM FOR DEPARTMENT OF DEFENSE INSPECTOR GENERAL

SUBJECT: Review of Draft Report on Controls over Navy Working Capital Fund
Inventory Stored at Non-Defense Logistics Agency Organizations (D2007-
D000FC-0162.000)

Reference: DoDIG Draft Report of 12 Mar 08

Thank you for the opportunity to comment on the draft report on "Controls Over
Department of the Navy Working Capital Fund Inventory Stored at Non-Defense
Logistics Agency Organizations."

We concur with the report recommendations. Our comments are provided in the
attachment and address the status of corrective action or in the case of recommendations
#2 and #3, an estimate when action will be completed.

My point of contact for this matter is CDR Elie Kutney, who can be reached at (703)
692-4892 or email: elie.kutney@navy.mil.


Douglas A. Brook

Attachment:
As Stated

DEPARTMENT OF THE NAVY
COMMENTS ON DODIG DRAFT REPORT
(D2007-D000FC-0162.000) OF 12 MARCH 2008

Finding #1: Adequacy of Controls over Navy Working Capital Fund (NWCF) Inventory.

Physical inventory controls at 11 Naval Supply Management (NSM) activities were generally adequate to accurately report and safeguard NWCF inventory. However, inaccurate inventory data existed within Material Financial Control System (MFCS) and local logistics systems. The inaccuracies existed because of:

- Industrial Logistics Support Management Information System (ILSMIS) system conversion programming errors;
- incomplete reconciliation procedures between MFCS data and the local logistics systems data; and
- improper receipt, storage, and shipment of inventory items at NSM activities.

Although these inaccuracies did not result in material inventory discrepancies, they could cause delays in issuing supplies to the warfighter.

DON Response: Concur. Inventory discrepancies noted at the Fleet and Industrial Supply Center (FISC) Norfolk Crane Division caused from ILSMIS Graphical User Interface (GUI) conversion process have been identified for corrective resolution. All priority one and 80 percent of priority two system discrepancies identified during the audit have been rectified. An already established System Project Team including members from FISC Norfolk Crane, Naval Surface Warfare Center Crane, and NAVSEA Crane has taken a more aggressive approach with regard to identifying future system issues and monitoring their timely resolution.

Recommendation #1a. We recommend the Commander, Naval Supply Systems Command notify FISC Norfolk Crane Division of systemic programming errors to enable Crane Division to initiate and monitor Systems Change Requests (SCR) for resolution through the ILSMIS Function Review Board.

DON Response: Concur. FISC Norfolk, Crane Division established a process to identify any systemic problems that occur in ILSMIS. When a discrepancy is found a SCR is generated and submitted to the Functional Review Board for resolution. Action is considered complete for reporting purposes.

Recommendation #1b. We recommend the Commander, Naval Supply Systems Command ensure warehouse personnel are properly and continuously trained to receive, store and ship inventory items to optimize the accuracy and accountability of inventory at each Navy Supply Management activity.

DON Response: Concur. Commander, Naval Supply Systems Command will ensure warehouse personnel are properly trained on receipt, stow and issue procedures on a routine and regular basis to ensure accurate inventory accountability is maintained at each Navy Supply

Attachment

Management activity. In addition, all FISC assessable units which address training will be revised to include warehouse personnel training on the receipt, stow and issue procedures and training records will be properly documented. Estimated completion date for revising FISC assessable units on training is 31 October 2008.

Recommendation #2. We recommend the Commander, Naval Inventory Control Point (NAVICP) continue implementing the automated procedure to ensure accuracy and accountability of inventory data between the MFCS and the Relational Supply system (R-Supply).

DON Response: Concur. NAVICP will continue working with the activities on resolving any existing inaccuracies and implementing procedures to ensure accuracy and accountability of inventory data between the MFCS and R-Supply system. Estimated completion date is 1 April 2010.

Recommendation #3. We recommend the Commanding Officer, FISC, Norfolk implement a location survey program at its Crane Division to provide greater accuracy and accountability of inventory at each Navy Supply Management activity.

DON Response: Concur. FISC Norfolk Crane Division has established a requirement to complete 100 percent location survey for all NWCF inventory within the three year required periodicity (between 1 January 2008 and 1 January 2011). A Location Survey Plan of Actions and Milestones along with a Location Survey Implementation Plan has been established to ensure full compliance. Location Survey completion has been incorporated within the already established Inventory Schedule compliance reporting process which is monitored at FISC Norfolk. Location survey project completion will take approximately two years and is estimated to be completed by 1 April 2010.

Technical Correction:

Page 1. Background Section of the draft audit report, on page 1, revise the Naval Surface Warfare Centers to Naval Surface and Undersea Warfare Centers for the first bullet titled 'ILSMIS'.

Revised

Team Members

The Department of Defense Office of the Deputy Inspector General for Auditing, Defense Financial Auditing Service prepared this report. Personnel of the Department of Defense Office of Inspector General who contributed to the report are listed below.

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